U.S. Department of Labor
Program Highlights

Fact Sheet OCWC-03-1

How to Use the Employment Cost Index for Escalation

The Employment Cost Index (ECI), published by the U.S. Department of Labor's Bureau of Labor Statistics (BLS), is a quarterly measure of the change in the cost of labor, free from the influence of employment shifts among occupations and industries. The compensation series includes changes in wages and salaries and in employer costs for employee benefits. The wage and salary series and the benefit costs series provide the changes for the two components of compensation.

The ECI is designated as a principal economic indicator. It is the only measure of labor costs that treats wages and salaries and total compensation consistently, and provides regular subseries by occupation, industry, and region. The ECI is used by the Federal Reserve Board to monitor the effects of fiscal and monetary policies and to formulate those policies. According to Federal Reserve Board Chairman Alan Greenspan, "The ECI is indispensable to understanding America's economy. It ensures the accuracy of the statistics on employers' compensation costs that we rely on for economic policy making and successful business planning."

The ECI is particularly well suited as a vehicle for adjusting wage rates to keep pace with what is paid by other employers for two reasons. First, it is comprehensive. It includes not only wages and salaries but also employer costs for employee benefits, and covers nearly all employees in the civilian (non-Federal) economy. Second, it measures the "pure" change in labor costs; that is, it is not affected by changes in relative employment of industries and occupations with different wage and compensation levels.

Guidelines for Escalator Clauses

The following are general guidelines to consider when developing an escalation agreement using the Employment Cost Index:

SPECIFY the costs to be escalated (wages and salaries, benefits costs, or total compensation). Indicate the specific occupations covered; indicate the month or year of the base labor costs; indicate the reference quarter to be used; and specify how long the contract will be in effect.

IDENTIFY an appropriate index and series. Choose the index and series that is reflective of the occupations you are trying to escalate (for example, ECI for Total Compensation (not seasonally adjusted), private industry workers, service-producing industries, white-collar occupations excluding sales). An important consideration when choosing a series for use in escalation is the sampling error. Series with smaller numbers of workers may have larger sampling error or may be dominated by a small number of employers. For example, local area indexes often exhibit greater volatility than the national index, although the long-term trends are similar.

STATE the frequency of adjustment. Adjustments usually are made at fixed time intervals, such as quarterly, semiannually, or, most often, annually.

COMPUTE the percentage increase. Divide the index number for the most recent period by the index number for the prior period to determine the percentage increase. Multiply one plus the percentage increase by the base labor cost to determine the escalated labor cost.

PROVIDE for missing or discontinued data. (For example, use the white-collar series if an administrative worker series has been discontinued.) Procedures should be specified to cover cases in which required data are missing or discontinued (although both are rare).

AVOID locking indexes used for escalation into any particular reference period (for example, 1982 = 100). Periodically, the ECI will change its index base. The index base to be used should be the one in effect at the time the adjustment is to be made, which may not be the one in effect when the contract was written.

Example of Escalator Clauses

Suppose a collective bargaining agreement contains the following language:

"For years two and three of this contract, on July 1 of each year, basic hourly wage rates for each step and grade will be adjusted by the percentage change in the Employment Cost Index for private industry workers, wages and salaries (not seasonally adjusted), from March of the prior year to March of the current year. That is, the increase to go into effect on July 1, 2002 will be the increase in the ECI series between March 2001 and March 2002, while the increase to go into effect on July 1, 2003 will be the increase in the ECI between March of 2002 and March of 2003."

The cost to be escalated is: wages and salaries

The index to be used is: private industry workers, wages and salaries (not seasonally adjusted), March quarter

The frequency of adjustment is: annually

The calculation is: Assume that, in June 2001, wage rates for three occupations were as follows:

Carpenters	$15.42
Janitors	7.45
Truckdrivers	14.00

The ECI private industry wages and salaries index for March 2001 is 149.4 and that for March 2002 is 154.7. Then, the adjustments dictated by the contract language would be 154.7/149.4 = 1.035

$15.42	*	1.035	=	$15.96
7.45	*	1.035	=	7.71
14.00	*	1.035	=	14.49

Caveats

The ECI is published on a seasonally adjusted basis as well as on an unadjusted basis. Seasonal adjustment removes the effects of events that follow a more or less regular pattern each year. These seasonal adjustments make nonseasonal patterns easier to identify. The primary use of seasonally adjusted data is for current economic analysis. The factors that are used to seasonally adjust the data are updated annually. Also, seasonally adjusted data that have been published earlier are subject to revision for up to 5 years after their original release. For these reasons, the use of seasonally adjusted data in escalation agreements is inappropriate.

BLS neither encourages nor discourages the use of wage adjustment measures in contractual agreements. Also, while BLS can provide technical and statistical assistance to parties developing escalation agreements, we can neither develop specific wording for contracts nor mediate legal or interpretive disputes that might arise between the parties to the agreement.

Additional Sources of Information

For more detailed information on escalator clauses, see Albert E. Schwenk, "Escalation in Employer Costs for Employee Compensation: A Guide to Contracting Parties," *Compensation and Working Conditions*, Spring 1997, found at **http:/www.bls.gov/opub/cwc/1997/spring/art1abs.htm.** (Prior issues can be found under Archives.) For a copy of this report or for any additional information about the ECI, call or write to:

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